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SUBJECT: POLITICIANS PRESS CENTRAL BANK TO CUT INTEREST
RATES

REF: ANKARA 3319

1. (SBU) Government ministers continue to ratchet up the pressure on the Central Bank to cut overnight interest rates, arguing that such a move is needed to weaken the recently-robust lira and prevent Turkey's growing current account deficit from deteriorating further.

2. (SBU) The pressure began to rise last Friday, after the Central Bank reported that the current account deficit had reached 2.368 billion in the first quarter, compared to a \$479 million deficit in the first quarter of 2002. The official target for the year is \$3.5 billion. Shortly after the Bank's announcement, Finance Minister Kemal Unakitan predicted a rate cut "soon." Prime Minister Erdogan said he was confident the Bank would lower rates, adding that a 3-5 percentage point cut (from the current 41 percent) would help "balance" the exchange rate. "We hear the suffering of the business world. God willing the Central Bank governor and his team hear the sensitivity on this issue, and I think they will take the necessary steps."

3. (SBU) On May 28, following a meeting with the visiting IMF Mission Chief, Union of Chambers President Rifat Hisarciklioglu publicly reminded politicians that the Central Bank was an independent organization and should not be pressured on interest rates. Such pressure, he warned, would hurt Turkey's image in global markets. Industry Minister Ali Coskun replied that the GOT was not interfering in the Central Bank's business, but said he personally expected the Bank to be "sensitive" and reduce interest rates further.

4. (SBU) State Minister Kursad Tuzmen, the always outspoken advocate of exporters, issued the strongest statement so far today. He urged the Bank to take steps immediately to weaken the lira, warning that "independent bodies preserve their independence by acting earlier, more actively, before their independence becomes a subject for debate. That would be craftsmanship, competence."

5. (SBU) Central Bank Governor Sureyya Serdengeçti told us last week (reftel) that the Bank would not stray from its own measures to determine whether and when to lower interest rates. Serdengeçti defended the Bank's independence in a speech to opposition CHP deputies today, reportedly saying that "you don't cut rates just because the markets expect it or because there is political pressure to do so."

6. (SBU) Some market analysts are joining the call for Central Bank action. HSBC argued that, since the strong lira was putting downward pressure on inflation and inflationary expectations were falling, there was a strong economic argument for a rate cut, which in turn would allow yields on government t-bills to fall. Other analysts said growing expectations for a rate cut contributed to today's decline in t-bill yields, with the benchmark 07/07/04 bill paying 48.76 percent, down from 50.15 percent Tuesday.

7. (SBU) Comment: Whatever the arguments for a rate cut, this strong public, political pressure puts the Central Bank in a bind. Should it decide to reduce overnight rates, it will be hard pressed to convince observers that it is doing so for economic reasons rather than in response to political pressure. CB Governor Serdengeçti is acutely aware of the need to maintain credibility, and of how quickly he can lose that credibility if markets begin to question his

independence and commitment to disinflation.
PEARSON